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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 93-215
	)	
Rate Regulation	)	

REPLY COMMENTS
OF
THE SMALL CABLE BUSINESS ASSOCIATION

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SUMMARY

As the Commission continues its efforts to craft a comprehensive rate regulatory scheme for cable operators, the Small Cable Business Association ("SCBA") submits these Reply Comments to focus the Commission's attention on the unique and often disparate impact which its proposals may have on the operators of small cable systems as well as small cable businesses, regardless of individual system size.

SCBA has previously demonstrated to the Commission why the benchmark rate system will not provide adequate revenues to fully recover the costs associated with the operation of smaller cable systems as well as smaller cable businesses. Absent substantive changes in the benchmark rates to reflect certain attributes of smaller systems and smaller businesses, such systems and businesses will be forced to rely on the cost-of-service safety net.

As the Commission seeks to simplify a potentially complex cost-of-service procedure, the Commission is proposing industry-wide uniformity in the factors used to compute permissible revenue levels. This "one-size-fits-all" approach, SCBA maintains, will stretch the safety net to a point where the holes between the net's webbing will become large enough for small cable systems and small cable businesses to fall through, thereby being afforded no protection whatsoever.

Specifically, SCBA strongly urges the Commission to consider modification of its cost-of-service proposal in the following areas:

1. Industry-wide average rates of return cannot be used since smaller businesses have inherently greater risk than larger businesses;

2. The Standard & Poors 400 bears no relationship to the cost of equity of either the cable industry or the smaller cable businesses and small systems and should not be used by the Commission;

3. The Commission should allow operators to use costs of equity based on a Capital Asset Pricing Model risk premium analysis;

4. Capital cost recoveries must facilitate transition in capital structure so as not to stifle capital attraction;

5. The ratebase and cost-of-capital must be crafted in such a manner that small businesses and operators of small systems, many of which are highly leveraged, can earn revenues sufficient to service debt and attract capital in the future;

6. The ratebase must include prior unrecovered losses on which a return should be earned and such losses should also be amortized over a period of years;

7. Intangible assets should be included in the ratebase for smaller businesses and operators of small systems since these entities have typically not earned monopolistic profits from such businesses; and

8. The Commission should adopt its streamlining proposals, especially with respect to limited cost-of-service showings to provide additions to benchmarks for certain specified types of costs.

The traditional utility-based cost-of-service model is of limited use for small cable systems and small cable businesses as many are highly leveraged. The narrowly defined ratebase suggested by the Commission will not allow many of these businesses to earn returns sufficient to service existing interest expense, let alone repay principal. Such a restrictive rate mechanism will also impair the ability of these businesses to attract capital, hindering the continued growth of the information infrastructure in rural America.

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I. INTRODUCTION

A. The Small Cable Business Association

Faced with an unprecedented labyrinth of seamless regulations, several small operators decided to form a self-help group to learn, understand and implement the new requirements. Notice of this group's first meeting spread and on Saturday May 15, 1993, one hundred operators met in Kansas City, Missouri. By the end of the day, the Small Cable Business Association ("SCBA") was formed.

While still in its infancy, SCBA has rapidly grown to over 240 members. More than half of them have fewer than 1,000 subscribers in total. Current SCBA members are listed in Exhibit A.

B. **Effect on Infrastructure Development**

The Commission has acknowledged that it "agrees that cable operators can, and should, contribute to the continued development of an advanced telecommunications infrastructure."[1] This is consistent with Congress' stated policy goal of ensuring that cable operators continue, where economically justified, to expand their telecommunications infrastructure.[2]

The Commission must take into consideration the impact that rate regulation has not only on the ability of cable operators to maintain current service levels, but also on the ability of operators to contribute to the creation of a national broadband telecommunications infrastructure. The Commission must be mindful that if the cost-of-service methodology it crafts places disparate burdens on small systems or small cable businesses, it will cripple their ability to retain and attract capital.

Although metropolitan areas serviced by the Regional Bell Holding Companies[3] and larger cable MSOs, already have access to broadband fiber optic technology, how fast such

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[1]In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, *Notice of Proposed Rulemaking*, MM Docket 93-215 (Released July 16, 1993) ("*Notice*").

[2]Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"), Section 2(b)(4).

[3]For example, a review of the various Ameritech Bell Companies' Form 10-Ks reveals that while Ameritech services approximately 60 - 80 percent of the populations in each of its states, Ameritech companies only provide service to 15 - 25 percent of the geographical area. Consequently, areas with lower population densities (i.e., smaller cities and many rural areas) must rely upon cable operators and independent telephone companies to provide them with connectivity to the national broadband infrastructure.

technology "trickles" down to others has historically been influenced by public policies.[4] Looking retrospectively at the deployment of universal telephone service, Commissioner Barrett has written:

> Had the states and the nation failed to make a conscious commitment to universal service, it would have been a long time before some parts of the country, and some customers, had telephone service. Even though it is widely recognized by now that all customers, residence and business alike, benefit from having telephone service widely available and widely used, it took farsighted people to bring universal service into reality.[5]

SCBA believes that this Commission will be farsighted in applying both its benchmark and cost-of-service rate mechanisms in a manner that will not be detrimental in their effects on small cable systems and small cable businesses -- effects that would slow the deployment of the benefits of the advanced broadband information infrastructure to rural America. In that light, SCBA requests that the Commission focus special attention on the concerns raised in these and prior comments[6] and tailor rate mechanisms to address the special needs of these small businesses and operators of smaller systems[7].

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[4]Barrett, Andrew C., *Public Policy and the Advanced Intelligent Network*, 42 Federal Communications Law Journal 413 at 419.

[5]*Id* at 419-420.

[6]SCBA filed Combined Comments and Reply Comments dated August 30, 1993, in MM Dockets 92-266 and 93-215, respectively.

[7]As used throughout these Reply Comments, the term "small business" connotes small businesses which operate cable systems, regardless of individual system size. The definition of "small" for these regulatory purposes should be developed by the Commission in conjunction and with the approval of the Small Business Administrator. Similarly, the term "small system" connotes systems which have higher costs due to their size as well as the types of geographic areas they serve (i.e., low density) and are not and should not be limited to systems with fewer than 1,000 subscribers.

II. INDUSTRY-WIDE AVERAGES CAN DISPARATELY IMPACT SMALL BUSINESSES

A. "Industry-Wide" Averages Must Be Stratified

As a general proposition, wherever in its cost-of-service proposals, the Commission has suggested using "industry-wide" average amounts or rates, the Commission must, at a minimum, provide a range of amounts or rates available to smaller systems and small cable businesses based on certain factors such as subscribers per system or franchise area. Additionally, since cost-of-service is the "backstop"[8] or "safety net," operators must always have the option of using data unique to their operations where conformance with the industry average would not provide an adequate revenue stream.

B. The Commission Must Gather Information From All Sizes Of Cable Systems And Cable Businesses

The Commission is reportedly refining a Preliminary Cable Cost Study for use in development of its cost-of-service regulations. This survey will reportedly be sent *only* to the "major MSOs."[9] Unless representative data are collected and applied to cost-of-service proceedings for operators of small systems and small businesses, the cost-of-service methodology will be so skewed against these operators that it will be useless to them. As expanded upon throughout these comments, the cost structure of major MSOs as well as their ability to solicit capital in the international capital markets simply makes a rate scheme tailored to such operators unusable for operators of small systems and small businesses.

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[8]*Notice* at Par. 7.

[9]*FCC Preps Cable Cost Study Draft*, Multichannel News, September 6, 1993, p. 45.

III. SMALL BUSINESSES AND SMALL SYSTEMS SHOULD BE ALLOWED TO EARN A HIGHER RATE OF RETURN ON EQUITY

A. Statistics Derived From The S&P 400 Bear No Relationship To Those Appropriate For Small Systems And Small Cable Businesses

The Commission solicited comment on: (1) whether it should use a cost of equity based on the average S&P 400 companies or on companies in a particular earnings quartile of the S&P 400; and (2) on the relative risks of cable businesses as compared to the S&P 400 companies[10].

According to our discussions with Standards & Poors Corporation, the S&P 400 is currently comprised of approximately 388 publicly traded industrial stocks which have the highest market values of publicly traded stocks. In other words, these are the largest publicly traded corporations, most of which do not operate in a heavily regulated environment with respect to the rates they can charge. No group of businesses could be more dissimilar to operators of small cable systems or small cable businesses.

1. The S&P 400 Is A Valid Measure Of Telephone Company Cost of Equity

The Commission has extensively compared the S&P 400 index to attributes of the Regional Bell Holding Companies ("RHC"),[11] finding that the cost of equity for the RHC's was consistent with the lowest quartile of the S&P 400 stocks. Determinations of cost of equity were based on stock prices, dividends and growth[12].

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[10]*Notice*, Par. 52.

[11]In the Matter of Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes, MM Docket No. 92-133 (Released July 14, 1992) at Par. 58 - 62, ("*Telco Represcription Order*").

[12]*Id*. at Par. 61 - 63.

Although the S&P 400 may be a valid indicator of the cost of capital for equity of telephone stocks, it does not bear the same relationship to the cost of equity of cable operators. A comparison of the overall market value of the S&P 500[13] composite stocks to the value of telephone companies reveals that the value of telephone stocks mirrored or exceeded the market value of the S&P 500 stocks[14]. This supports the proposition that the beta factor[15] of telephone companies is generally less than one[16].

2. <u>The S&P 400 Bears No Relationship To The Cost Of Capital Of Cable Operators</u>

On the other hand, market values of the composite of broadcast and cable television stocks[17] does not track with the S&P composite market values[18]. This variation suggests that the beta values of these stocks is greater than one. Although Standard & Poors

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[13]The S&P 400 is a subset of the industrial stocks contained in S&P 500. Standard & Poors no longer publishes information on the S&P 400. Therefore, comparisons must be made to the S&P 500 which is largely comprised of the S&P 400.

[14]See Composite vs. Telephone comparison enclosed as Exhibit B, as published in Standard & Poor's *Analyst's Handbook* (1992), p. 148.

[15]The beta factor measures a stock's volatility relative to an average stock. A beta factor of less than one indicates that it is less risky than the average market investment while a beta factor of more than one indicates a stock has greater risk due to its greater volatility. Brigham, Eugene F., *Financial Management Theory and Practice* 2d., p.108.

[16]For example, the following telephone companies are listed with their respective beta factors according to the *Value Line Investment Survey* 5th ed., pp. 747 - 771: Ameritech, 0.80; Bell Atlantic, 0.90; Bellsouth, 0.80; GTE Corp., 0.90; NYNEX, 0.85; Pacific Telesis, 0.90; Southwestern Bell, 0.90; and U.S. West, 0.85.

[17]Major investment and industry analysis entities such as Standard & Poors and Value Line group broadcast and cable into a single industry group.

[18]Exhibit C contains a chart from Standard & Poor's *Analyst's Handbook*, (1992), which shows that the stock values of the broadcast stocks varied significantly from the S&P 500 composite values.

aggregates broadcast and cable television stocks for purposes of this analysis, it is the cable stocks which skew the data[19]. The largest publicly traded cable operators have significantly higher beta factors than both broadcasters and telephone companies[20].

Certainly if these publicly traded giants of the cable industry have beta values 50 to 100 percent higher than telephone companies, small cable businesses and operators of small cable systems, both of which are inherently more risky than larger more diversified entities, will have even higher beta values.

In fact, the beta values for the cable industry as a whole may be understated in our analysis. A principal flaw in beta analysis is that it is based on *ex ante* (i.e., expected) conditions, yet the betas are computed on *ex post* (i.e., past) data[21]. Thus, the betas calculated show how volatile a stock has been in the past, but if conditions change in the future, volatility may change. In fact, much of the analytical data used by Value Line and Standard & Poors is based on a period during which cable television was substantially unregulated. Now, however, with the imposition of stringent rate and other regulations, cable stocks may be subject to even greater market volatility.

In light of the forgoing, any cost of equity which is based on the S&P 400 simply is not reflective of the cost of capital of cable operators in general, and especially that of small

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[19]According to the *Value Line Investment Survey*, 5th ed., the betas of broadcast stocks are generally 1.0 or less than 1.0. For example, CBS, Inc. has a beta of 0.95 while Capital Cities/ABC has a beta of 1.00.

[20]A review of the *Value Line Investment Survey* 5th ed., pp. 379 - 389 reveals the following beta factors: Cablevision Systems Corporation, 1.45; Comcast Corp., 1.60; and Telecommunications, Inc., 1.65.

[21]*Brigham* at p. 115.

cable businesses as well as operators of smaller systems.

B. **Risk Premium Analysis Of Cost Of Equity**

If the S&P 400 is not used to compute the cost of equity capital, traditional valuation models also pose unique problems. Small cable businesses, as well as the operators of smaller systems are typically closely held corporations or partnerships, the shares of which have no ascertainable market value. Furthermore, dividends or distributions are made infrequently, as often the earnings, if any, are reinvested in the business.

Even the discounted cash flow method suggested by the Commission is subject to significant subjective debate as revenue streams to owners in the form of earnings on equity may be erratic. Additionally, typically the owners of these businesses are also the principal employees, and therefore their compensation, including incentive compensation, may in some cases supplant traditional forms of return on equity.

A less subjective measure of required return on equity could be determined by a variation of the Capital Asset Pricing Model ("CAPM"). Under the CAPM, investors require a rate of return equal to the current risk-free rate plus a risk premium which is determined by the unique characteristics of each company[22]. The risk free rate is the current yield on long-term U.S. Treasury Bonds[23]. The current yield on a 20 year U.S. Treasury Bond is 6.62 percent[24].

A more comprehensive analysis is required to determine the risk-premium to be

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[22]Pratt, Shannon P., *Valuing A Business; The Analysis and Appraisal of Closely Held Companies*, (2d ed. 1989), pp. 45 & 46.

[23]*Id.* at p. 198.

[24]Wall Street Journal, Friday September 10, 1993, p. C-7.

added to the risk-free rate to compute the overall capitalization rate. Factors which should be included in this analysis include:[25]

1. General economic conditions;
2. Industry-specific factors; and
3. Company-specific factors.

The greater the risk factors, the higher the requisite rate of return must be in order to justify investment in the business.

While operating in a heavily regulated industry with stringent regulation of rates and other operating attributes certainly raises the risk levels, small cable businesses and operators of smaller systems have attributes, including reliance on a few key operating personnel (i.e., typically owner operated businesses), highly leveraged and high variability of earnings[26] which also contribute to the entities' risk.

An accepted method of determining the discount factor used in the Capital Asset Pricing Model, which would also be equivalent to the required cost of equity[27], can be ascertained by adding to the risk-free rate of return a risk premium derived by reference to

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[25]Zukin, James H., *Financial Valuation: Business and Business Interests* (1990), ¶5.1[3].

[26]The SCBA surveyed its members to determine various attributes to help the Commission craft its cost-of-service regulations. The survey responses indicate that small operators are highly leveraged. On the average, operators have debt levels equal to 93 percent of total assets, with some operators having debt exceeding 200 percent of assets. The median level of debt was 100 percent of assets. In addition to many operators posting operating losses, the year to year variability of such earnings was also significant.

[27]Brigham at p. 561.

a table of business characteristics developed by James H. Schilt[28].

In the table of five categories identified by Schilt[29], small cable businesses and operators of small systems seem to fit best below category 2, but no lower than category 4[30].

Category 1 does not apply since most such businesses and systems are not well financed, do not have depth in management, have not had stable past earnings and certainly do not have a future that is highly predictable.

Category 2 does not apply since small businesses and systems typically lack adequate financial resources, do not have depth in management or stable past earnings and do not have a predictable future.

Category 3 is closer in that such businesses and operators typically do not have management depth and the element of risk is high.

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[28]Schilt, James H., *Selection of Capitalization Rates for Valuing a Closely Held Business*, Business Valuation News 1982, and Schilt, James H., *Selection of Capitalization Rates - Revisited*, Business Valuation Review, June 1991, p. 51. (Copies enclosed as Exhibit C). The various risk premiums were determined based on a quantitative analysis of historical equity risk premiums such as those published by Ibbotson Associates. (See, e.g., Ibbotson and Sinquefeld, *Stocks, Bonds, Bills and Inflation:* Updates, Financial Analysts Journal, July - August 1979).

[29]Although the Schilt model is based on the capitalization rate rather than the discount rate typically used to determine cost of equity, the discount rate is equal to the capitalization rate where the growth rate is equal to zero. Under the Commission's rate structure, it is doubtful that operators will be able to increase rates faster than the rate of inflation, or the rate of increases in actual costs. Additionally, productivity gains for small businesses and systems are also highly speculative. Therefore, it is likely that there will be no real rate of growth in cable earnings in the foreseeable future. Hence, the discount rate will be equal to the capitalization rate in the instant analysis. See, e.g.,Sliwoski, Leonard, *Capitalization Rates, Discount Rates, and P/E Ratios:* One More Time, Business Valuation Review, September 1992, p. 122.

[30]For a complete description of each category, see Exhibit D.

Similarly, Category 4 is also relevant to certain operators since many small businesses rely upon the special skills of one or two people. In addition, especially with the onset of regulation, future earnings may be expected to deviate widely from projections.

For discussion purposes, even if we assume that the appropriate risk premium is the midpoint of the lowest applicable category (i.e., category 3), the risk premium is still 18 percent[31]. When added to the current risk-free rate of 6.62 percent, the cost of equity under the Shilt model would be 24.62 percent. This is substantially higher than the proposed return on equity in the Commission's *Notice* of "around 15 percent."[32]

In fact, the cost of equity of large, publicly held companies which do not bear anywhere near the risk associated with cable operators simply cannot be used as a measure of cable operator rates of return, especially for small businesses and small systems. In reality, the Commission must independently determine the appropriate costs of equity for cable operators by employing CAPM techniques. SCBA maintains that the only accurate way to make such determinations is through use of a risk analysis model such as the Schilt model. It is also essential that the rate of return identified by the Commission be stratified so that small cable businesses and operators of small systems with higher inherent risks are permitted to earn a higher rate of return than larger businesses.

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[31]Nevertheless, under the Schilt model an appropriate risk premium for small operators would be 25 percent.

[32]*Notice* at ¶ 52.

IV. OPERATORS SHOULD BE ALLOWED TO EARN REVENUES BASED ON THEIR ACTUAL COST OF DEBT

A. Proposal To Use Surrogate Industry Rates Will Harm Many Small Cable Businesses

The Commission proposes using a surrogate industry's cost of debt to determine an appropriate cost of debt for all cable operators[33]. Use of a surrogate is just as misplaced as reliance on the S&P 400 to determine the cost of equity. Since such information must be publicly available, its use presupposes that the companies under review would be publicly traded.

The use of *any* publicly traded company information is simply inappropriate since the cost of debt of large companies which have access to international capital markets and debt that is subject to significantly lower default risk cannot be used to measure the cost of debt of small, closely held businesses as well as the cost of debt attributed to the operation of small cable systems.

B. Establishment Of Presumptively Reasonable Cost Of Debt

If the Commission desires to establish one or more cost-of-debt standards for certain systems which would be presumptively reasonable for operators of various systems or sizes, such determinations must be made by surveying operators in each category. The appropriateness of information from any other industry simply cannot be assumed or stipulated.

C. Flexibility To Use Actual Cost Of Debt

A survey of SCBA members showed that those operators with third party debt paid

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[33]*Notice* at ¶ 53.

a wide range of interest rates[34]. Therefore, the smallest businesses with the highest level of risk which would typically pay the highest interest rates, would not be able to avail themselves of cost-of-service showings unless they could use their actual cost of debt to compute their rates.

Since most smaller businesses and many operators of small systems are most vulnerable to harm from the Commission's stringent rate regulations, failure to allow use of actual cost rates, determined through arms length negotiations with third parties, would place the weakest and smallest of these businesses at even greater risk. There is simply no justification for such disparate treatment.

V. COMPUTATION OF COST OF CAPITAL MUST PERMIT TRANSITION AND REFORMATION OF CAPITAL STRUCTURES

The Commission solicited comment on a variety of capital structure issues. Based on our conversations with Commission staff personnel, some believe that the cable industry should accept an 11 or 12 percent overall cost of capital since individual computations by highly leveraged operators would result in substantially lower rates of return.

As previously cited, a survey of SCBA members showed that many are highly leveraged[35]. Many also pay interest rates below 11 or 12 percent. Therefore, use of

[34]Interest rates varied from 6.0 to 15.5 percent, with many being tied to a premium over the prime rate or rate indices.

[35]The broadcast/cable industry appears to be much more highly leveraged than the both the S&P 500 composite and the telephone industry. According to the Standard & Poor's *Analysts Handbook* (1992) the level of 1991 assets to long-term debt for the S&P 500 composite was 21 percent compared to 54 percent for the broadcast/cable industry. On the other hand, SCBA members averaged 83 percent assets to debt. Although information for the total telecommunications industry is not available, the long distance component of the industry averaged a ratio of only 21 percent.

traditional cost of capital methods would result in lower permissible rates of return. As discussed later in these comments, such lower rates of return would not permit many operators to meet debt service requirements over the long-term.

Additionally, the effects of application of traditional computations would have a profound negative impact on the cable industry, consumers and competition in the future telecommunications marketplace. From a policy perspective, the Commission cannot and should not lock the smaller members of the cable industry into their current capital structure.

A. **Many Small Business and Small Systems Current Capital Structure Will Hinder Capital Attraction**

Once again the discussion returns to the importance of capital attraction. Many small cable businesses and small system operators have little equity investment in their systems, regardless of whether the systems were built by their current owners or whether they were acquired after construction. Therefore, most of their current capital structure is debt.

If operators are permitted to earn revenues only sufficient to service its current debt structure, sufficient rates of return will not be earned to attract additional equity. If lenders' current fear of extending debt to the heavily regulated cable industry continues, small systems will need to look with increasing frequency to the equity markets. Based on past performance, however, most will be unable to attract new equity investors.

B. **Capital Costs Must Recognize And Allow Transition Of Capital Structures**

The Commission needs to recognize that the new rate regulations have greatly reduced the types and number of capital markets which are available to cable operators, especially small businesses and operators of smaller systems. Therefore, these businesses are in a forced state of transition. The Commission must permit rates of return which account for and permit mid- to long-term restructuring of these capital structures. The rate of return on capital must be greater than that necessary to service interest on debt and must include a significant equity portion at rates reflective of the risk associated with such cable entities.

The absence of such transitional consideration also would produce illogical results. Consider an operator with no debt being allowed to earn a 25 percent rate of return on its investment would have a vehicle to internally generate the capital necessary to participate in the development of a national broadband infrastructure. On the other hand, an entirely leveraged operator who is otherwise identically situated would be able to charge substantially lower rates and only cover interest payments (if even that). The latter operator would be forced to channel virtually all of its cash flow into interest and principal payments with little or nothing left over to upgrade its plant or participate in the infrastructure development.

As a matter of public policy, such results must be avoided. A cable business' rates and ability to expand in the future simply cannot be entirely dictated by the capital structure it happened to employ when rate regulation was instituted. The Commission must allow for transition.

C. **Rates Established On An Investment Cycle Basis Are Administratively Infeasible For Operators Of Smaller Systems and Small Cable Businesses**

The Commission is considering use of an investment cycle approach to measure the rate-of-return[36]. Under this approach, recoverable costs might be allocated over the life of the investment based on the proportion of total subscribers usage in the test year, with the rate-of-return measured over the projected life of the investment[37].

While this approach is certainly intellectually sound, and in fact appealing, it is totally unworkable for small businesses and operators of small systems. Based on our conversations with Commission staff, the approach requires that an operator project for the life of each system the number of subscribers in each year and the services that each will subscribe to each year. Not only will operators need to know the life of their system, but also what services will be offered each year, the manner in which they will be offered and the cost of providing the services. Cash flow projections are then made and discounted at an internal rate of return. The internal rate of return would then be used to establish the rate of return for cable operators to apply to the ratebase.

Not only do small businesses not have the internal expertise to compute such amounts, their crystal balls are simply not accurate enough to perform such projections. No one's is. Unless such computations were reperformed on an annual basis, the ability of operators to adapt to meet changing demands for services in their rapidly changing marketplace, the life cycle approach would lock operators into their current or predicted structures.

In addition to its highly speculative nature, the life cycle approach simply causes operators, franchising authorities and the Commission itself to engage in extensive financial

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[36]*Notice* at ¶ 56.

[37]*Id.*

gymnastics contrary to the Congressional mandate that the rate regulatory scheme be designed "to reduce the administrative burdens on subscribers, cable operators, franchising authorities, and the Commission."[38] The Commission should abandon any thought of using a life cycle approach to determine the appropriate rate of return.

VI. <u>THE RATEBASE PROPOSED BY THE COMMISSION IS UNDER-INCLUSIVE FOR MANY SMALLER BUSINESSES AND OPERATORS OF SMALLER SYSTEMS</u>

As will be shown, the ratebase proposed by the Commission is under-inclusive. It must include not only the value of its distribution plant, acquired intangibles, and working capital, but it must provide for recovery of prior losses.

A. <u>The Ratebase Must Be Adjusted To Allow An Adequate Rate Of Return, Including Preserving The Ability To Service Preexisting Debt</u>

The ratebase must be crafted with two unique factors in mind: (1) many smaller businesses and operators of smaller systems are highly leveraged and will not be able to meet debt service requirements; and (2) rate regulation is being imposed suddenly. Therefore, appropriate transitional factors must be taken into consideration.

The SCBA member survey revealed that many small businesses and operators of small systems have debt that equals or exceeds their total assets, net of depreciation and amortization[39].

Simply put, assuming an operator is allowed an 11 percent rate of return, and it pays

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[38]47 U.S.C. § 543(b)(2)(A).

[39]Of the members responding to the survey which had third party debt, the average percentage of debt to assets was approximately 90 percent, with some members having up to 207 percent debt as compared to assets.